

STAFF PAPER

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IASB® meeting

| Project | Accounting policies and accounting estimates (Amendments to IAS 8) | | |
|-------------|--|--|---------------------|
| Paper topic | Cover paper | | |
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Objective

1. The objective of this meeting is to ask the International Accounting Standard Board (Board) if it agrees with our analysis of, and recommendations on, matters identified in the feedback to the Exposure Draft *Accounting Policies and Accounting Estimates* (Proposed amendments to IAS 8) (Exposure Draft), including our recommendations on the project direction.

Summary of the proposed amendments

2. The proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* aim to help entities distinguish accounting policies from accounting estimates. More specifically, the proposed amendments would clarify:
 - (a) how accounting policies and accounting estimates relate to each other, by:
 - (i) explaining that an entity uses accounting estimates in applying accounting policies; and
 - (ii) making the definition of accounting policies clearer and more concise.

- (b) that selecting an estimation or valuation technique, used when an item in the financial statements cannot be measured with precision, constitutes making an accounting estimate; and
 - (c) that, in applying IAS 2 *Inventories*, selecting the first-in, first-out (FIFO) cost formula or the weighted average cost formula for interchangeable inventories constitutes selecting an accounting policy.
3. Appendix A to this paper reproduces relevant excerpts from the Exposure Draft.

Background

4. Several respondents to the Exposure Draft said the proposed amendments would help clarify the distinction between accounting policies and accounting estimates. However, several respondents also:
- (a) raised concerns on particular aspects of the proposed amendments;
 - (b) suggested providing additional clarity in particular areas; and
 - (c) suggested adding illustrative examples.

Some respondents also asked whether finalising the proposed amendments would lead to benefits that outweigh the cost.

5. Before developing our recommendations, we analysed the feedback on the Exposure Draft and formed preliminary views on how the Board could address that feedback, including the possible project direction. We obtained input on our preliminary views from the members of:
- (a) the IFRS Interpretations Committee (Committee), in September 2018;
 - (b) the Accounting Standards Advisory Forum (ASAF), in October 2018; and
 - (c) the Board, in April 2019.

Our analysis and recommendations in the papers for this meeting reflect this input.

Agenda papers for this meeting

6. In addition to this cover paper, we have included the following agenda papers to support our discussions with the Board:
- (a) Agenda Paper 26B *Analysis of feedback—definition of accounting estimates*. This paper analyses feedback on the proposed definition of accounting estimates which was included in the Exposure Draft and presents our recommendations on how to address that feedback.
 - (b) Agenda Paper 26C *Analysis of feedback—other aspects*. This paper analyses feedback on all other aspects of the Exposure Draft and presents our recommendations on how to address that feedback.
 - (c) Agenda Paper 26D *Project direction*. This paper presents our analysis and recommendations on project direction.

Summary of staff recommendations

7. In Agenda Paper 26B, we recommend that the Board:
- (a) revise the definition of accounting estimates to specify that:
 - (i) accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty;
 - (ii) these monetary amounts are outputs of measurement techniques used in applying accounting policies; and
 - (iii) an entity uses judgements and/or assumptions in developing an accounting estimate.
 - (b) clarify that:
 - (i) the effects of a change in an input and/or in a measurement technique used to develop an accounting estimate are changes in accounting estimates if they do not result from the correction of prior period errors; and
 - (ii) changes in accounting estimates that result from new information or new developments are not the correction of an error.

- (c) specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop accounting estimates.
8. In Agenda Paper 26C, we recommend that the Board:
- (a) not amend the definition of accounting policies (ie retain the existing definition of accounting policies in IAS 8);
 - (b) clarify that if a change is a change in accounting estimate, it cannot also be a change in accounting policy;
 - (c) not add discussion of whether selecting an inventory cost formula constitutes selecting an accounting policy (thus not adding material proposed in paragraph 32B of the Exposure Draft);
 - (d) confirm deletion of IE3 from the *Guidance on Implementing IAS 8*; and
 - (e) add to the *Guidance on Implementing IAS 8* examples that illustrate how an entity would apply the definition of accounting estimates. This material would accompany, but not be part of, IAS 8.
9. In Agenda Paper 26D, we recommend that the Board:
- (a) finalise the amendments with the modifications set out in paragraphs 7–8 of this paper; and
 - (b) not re-expose the amendments.

Next steps

10. If the Board agrees with our recommendations, we will present a paper at a future Board meeting setting out our analysis of the transition requirements, effective date and due process steps for the amendments to IAS 8. We will also consider whether it is feasible to align the timing of issuing these amendments with other amendments to IAS 8.

Appendix A—Extract from the Exposure Draft: Proposed amendments to IAS 8

Paragraphs 5, 32, 34 and 51–53 are amended and paragraphs 32A, 32B and 54F are added. Deleted text is struck through and new text is underlined. Paragraphs 33, 35–38 and 50 have been included for ease of reference, but are not proposed for amendment.

Definitions

5 The following terms are used in this Standard with the meanings specified:

Accounting policies are the specific principles, measurement bases, ~~conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements.

Accounting estimates are judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision.

~~*A change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.~~

...

~~Changes in a~~ Accounting estimates

32 As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision ~~but can only be estimated~~. Thus, an entity may need to use accounting estimates in applying its accounting policies for some items. ~~Estimation involves judgements~~ Accounting estimates are based on the latest available, reliable information. For example, estimates may be required of:

- (a) bad debts;
- (b) inventory obsolescence;
- (c) the fair value of ~~financial~~ assets or ~~financial~~ liabilities;
- (d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
- (e) warranty obligations.

32A When an item cannot be measured with precision, selecting an estimation technique or valuation technique to measure that item involves the use of judgement or assumptions

in applying the accounting policy for that item. For this reason, selecting that estimation technique or valuation technique constitutes making an accounting estimate.

32B Selecting one of the two cost formulas prescribed by paragraphs 25–27 of IAS 2 Inventories for ordinarily interchangeable inventories does not involve the use of judgement or assumptions to determine the sequence in which those inventories are sold. For this reason, selecting that cost formula does not constitute making an accounting estimate, it constitutes selecting an accounting policy.

33 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Changes in accounting estimates

34 An entity may need to change an accounting estimate ~~may need revision~~ if changes occur in the circumstances on which the accounting estimate was based or as a result of new information or more experience. By its nature, a ~~revision of change in an accounting estimate~~ does not relate to prior periods and is not the correction of an error.

35 A change in the measurement basis applied is a change in an accounting policy, and it is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.